

Letter from the Executive Director

“Retirement Board investment performance continued to, in general, meet or exceed expectations.”



The Commission and staff are pleased to release this Annual Report on the Massachusetts Public Retirement Systems for 2017. Retirement Board investment performance continued to, in general, meet or exceed expectations. This record supports the actions taken by the Commission in establishing investment return assumptions as part of the actuarial process. Investment returns in 2017 again generally compared well with public fund peers across the country and, as has been consistently the case for many years, long-term returns remained, in general, above assumptions.

The national debate regarding the appropriate investment return assumption to be used in actuarial valuations provides the backdrop for analyzing these results. As PERAC Actuary Jim Lamenza constantly reminds us, these are long-range assumptions based on decades of data and not on the experience of one or two years. In light of that fact, Jim and PERAC have led the way in the detailed analysis of investment return projections and the application of those projections to the Massachusetts public pension plans. As recently as 2003, the investment return assumption for 30 of our plans was 8.50%. Today, no plan is using that assumption. In 2003, all assumptions were 7.50% or

greater with only 3 between that level and 7.90%; 52 at 8.00%; 20 between 8.10% and 8.25% and, as noted, 30 used an assumption of 8.50%. Today, 27 plans use an assumption under 7.50%, 73 use a rate of return between 7.50% and 7.90%, and only 4 use a rate of 8.0%. PERAC's evolutionary approach to addressing the investment return assumption has assured that funding progress continues while moderating the fiscal impact of pension costs on state and municipal budgets.

Commission/Staff Update

Vacant positions in the Audit Unit were filled with the hiring of **Walter Kloc** and **Junior Yanga**. Walter is a Certified Bookkeeper who holds a Bachelor's Degree in Business Administration with over 20 years of accounting and private sector auditing experience, most recently as a Premium Auditor at RLD Associates. Junior holds Bachelor's Degrees in Accounting and Economics and has over 10 years of Accounting and Finance experience. He comes to PERAC after working as a Shareholder Service Specialist with Bank of New York Mellon.

Robert Perez assumed the position of Senior Systems Engineer in our Information Technology Unit. Robert has over 20 years of experience as a Systems Network Engineer and System Administrator. Most recently Robert was with New England Baptist Hospital.

In the Actuarial Unit **Michael Humbert** was hired to fill the position of Actuarial Analyst vacated by the departure of Kaitlyn Doucette, who accepted a position with the Methuen Retirement Board. Michael is a graduate of Brandeis University with a Bachelor of Arts Degree in Economics and Mathematics and recently passed the second exam on the road to becoming an Enrolled Actuary.

Also in the Actuarial Unit, **John Boorack** has achieved the status of Enrolled Actuary and Member of the American Academy of Actuaries after successfully completing a series of arduous examinations. John has been a valued member of PERAC's Actuarial Team for more than 20 years. During this time he has worked under the tutelage of the Actuary of the Commonwealth, Jim Lamenza.

As Jim noted, John's task in passing these exams was made more difficult by the fact that much of the material is geared for private sector pension practice and is not applicable for our public sector plans. Understanding the private sector material without working with many of these issues on a daily basis presented John with a unique challenge. We are all pleased with his success.

Fee Report

PERAC once again published a compilation of the fees paid by the pension systems to investment vendors. The report consisted of the Schedule 7 filed by each Board as part of its Annual Statement of Financial Condition. According to these submissions (some of which were incomplete or needed adjustment) retirement boards paid roughly \$440 million to investment service providers in 2017. For the State and Teachers' funds, which are invested by the Pension Reserves Investment Management Board (PRIM), \$279 million in fees were incurred. Local retirement boards paid \$161 million to money managers, banks and investment consultants, as well as PRIM.



2017 Investment Report, compiled by PERAC, of fees paid by pension systems to investment vendors.

The Annual Fee Report enables retirement boards to make comparisons between fees the board pays in connection with a particular manager or fund and the

fee other boards pay in connection with the same manager or fund. Armed with that information, a board can discern discrepancies between fee schedules and hopefully realize savings in the event it is paying more than its peers for the same service or product.

The level of cost in and of itself is neither a positive or negative but must be assessed in the context of returns as performance may justify cost.

It should also be emphasized that retirement boards must conduct their own analysis of the fees paid or expected to be paid in connection with investment activities. Over the last few years, our analysis has found that service providers often are unclear about not only the costs to the system but also the manner in which payment is made.

Contract Compliance

As you know, the original limit on the time frame for contracts set forth in Section 23B was expanded from five years to seven years by Chapter 46 of the Acts of 2015. That period is now coming to an end and boards should review the existing time frames for contracts and institute a program to conduct and complete searches before the new deadline. April 2019 will mark the outer limit for existing relationships, as seven years will have elapsed since the effective date of Chapter 176 of the Acts of 2011.

Accounting

Consistent with the need to insure accurate recordkeeping by retirement boards, PERAC has made several revisions to its accounting procedures that will be applicable beginning in calendar 2018. These include accounting for fees paid in conjunction with investment activity, as well as the tracking of "carried interest", "catch up payments" and "ancillary expenses" related to private equity, hedge fund, real estate, and similar investment vehicles.

Retirement boards are also reminded of their duty to submit complete and accurate cash books to PERAC on a timely basis. Accounting standards require that transactions be accurately identified and properly classified. The parties to whom payments are made, or from whom payments are received, must be identified and all transactions must be classified in the proper account.

Unfortunately, a number of systems have established a pattern of failing to comply with regulatory deadlines pertaining to these submissions, incorrect classification of accounts, as well as transactions. The Commission's past practice has been to work with the retirement board to resolve these matters. However, in some cases, the failings are so pervasive that in the future Orders to Protect the System will be considered to ensure the safety of system assets.

Emerging Issues Forum

PERAC held its Thirteenth Emerging Issues Forum at the College of the Holy Cross in September, 2017. Over 260 people participated and board members attending received three educational credits. In the keynote address, State Auditor Suzanne Bump elaborated upon recent technology upgrades at her office. Her perspective was most helpful, particularly in the context of the Commission roll out of the PROSPER system.



Keynote speaker State Auditor and PERAC Vice Chair, Suzanne Bump

Michael Trotsky of PRIM and Jim Lamenzo, PERAC's Actuary, led the session on Actuarial and Investment Perspectives. Providing some insight on the contentious issue of actuarial investment return assumptions, Michael provided the latest information on the PRIT Fund asset allocation and market analysis while Jim detailed his thinking regarding the appropriate methodology to be employed when setting that assumption.



PERAC Chairman, Phil Brown moderates the Retirement System Best Practices Panel

Although all of the presentations were excellent, the highlight of the day was the initial Retirement System Best Practices panel. The Panel featured four executive directors representing the various board sizes and types. Susana Baltazar of the Springfield Retirement System discussed her board's recent venture into digital board materials and how they have integrated PROSPER into their business practices. Lauren Durham, of the Hull Retirement System, gave an overview of the challenges faced by smaller boards, particularly with recruiting and retaining board members. Lisa Maloney, of the Middlesex County Retirement System, discussed change management and her experience coming into an established larger system. Irene Moran, of the MassPort Retirement System, gave an overview of the Comprehensive Annual Financial Report and its benefits. She brought along fantastic examples of past MassPort CAFRS.

The final session of the day, Pension Forfeiture: A Case for Change, discussed the outcome and recommendations from the Pension Forfeiture Commission. The panel consisted of several Commission members and its legal counsel: PERAC Executive Director, Joe Connarton, Norfolk County District Attorney, Mike Morrissey, Massachusetts Deputy Treasurer and State Retirement Board Executive Director, Nick Favorito, and PERAC Associate General Counsel, Patrick Charles. The presenters laid out the case for updating the existing law to increase equity and presented the issue from varying points of view.



Lt. Governor Karyn Polito providing opening remarks at PERAC's 13th Emerging Issues Forum

PROSPER

The full roll out of the PROSPER System is now complete, although we will be adding features and fine-tuning the program as we go forward. To date, boards seem pleased in general with the system and, in particular, it is the consensus that the Disability Application has simplified and expedited the disability process. Compliance has also been working hard to ensure that refinements take place to improve vendor disclosure filing, education tracking, and course registration. The application regarding Vendor Procurement seems to have made that task more user-friendly. We firmly believe that we are well on our way to a dramatic simplification of our interaction with board administrators, board members, and vendors.

Education

One of the true success stories of recent years has been the implementation of the mandatory education provisions of Chapter 176. Through its sixth year, that program has seen more than 10,000 course completions by retirement board members. These include 5,062 attendees at PERAC approved conferences including MACRS, 2,158 attendees at stand-alone PERAC events, 1,311 completions of Ethics Commission and Attorney General courses, and 153 completions of webinars.



Through its 6th year, the mandatory education provisions of Chapter 176 has seen more than 10,000 course completions by retirement board members.

In 2017, we launched a new program of one-day Board Administrator Trainings. Sessions were held in Northampton, Hyannis, and Danvers. All told, over 125 board administrators and board members attended one of the three sessions. Although geared toward the specific needs of board administrators, board members were welcome to attend and earned three credits for their attendance at this day-long seminar. Members of the Actuarial Unit, the Compliance Unit, and the Legal Unit at PERAC served as presenters. Many topics were covered in the course of each session. Attendees learned about "Calculations," "Anti-Spiking," "Running a Board Meeting," "Regular (and Irregular) Compensation," "Dual Members," "Buybacks," and "Interest." (The "Buyback" presentation also covered the different ways in which a member may be credited with previous, non-membership time.) Each day of training concluded with the award of certificates to all attendees.

We are finalizing plans for similar events to be held prior to the end of this year.

Legislation

On the legislative front, 2017 saw the adoption of legislation recommended by the Commission that repealed Section 90G^{3/4} of Chapter 32. That statute had required that an employee who had reached the age of 70 and wished to continue to accrue creditable service after that age and receive regular compensation had to elect to do so. As a result of this change, members simply continue making contributions and accruing creditable service after age 70 with no change in the pre-tax status of their contributions.

Conclusion

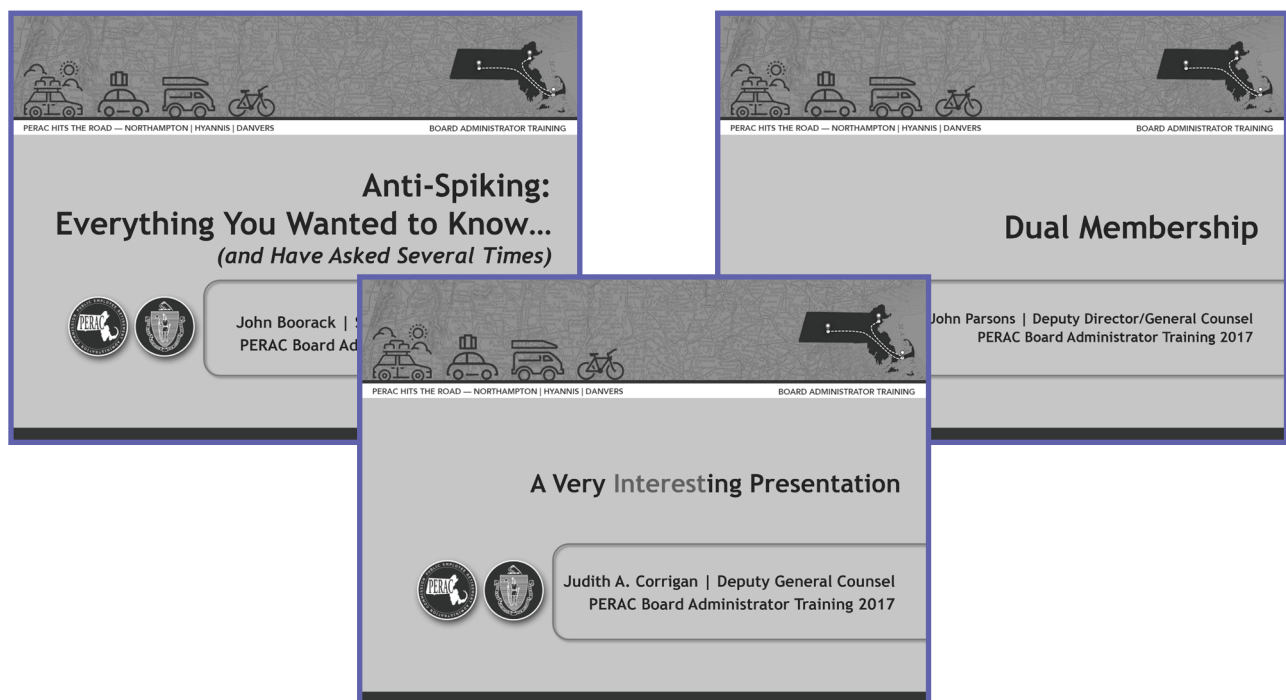
This year has been a challenging one as we instituted a complex and unprecedented system for interaction with the retirement boards, aggressively defended the pension system against ill-informed and sometimes malicious attacks, and sought to maintain progress towards fully funding retirement benefits. On all fronts we have been largely successful. However, recently there

has developed an antagonism towards the Commission that has been grounded not solely on honest disagreement but seems to be virulent and almost personal in nature. The Commission has worked to establish a cooperative and helpful relationship with the retirement community. We believe that, in general, that effort has been supported by the retirement boards and others in the pension community. It is our hope that as we move forward the interests of the members and their beneficiaries will remain paramount to all involved.

Sincerely,

Joseph E. Connarton

Joseph E. Connarton
Executive Director



Over 125 board administrators and board members attended one of our three Board Administrator Trainings covering 7 topics in 2017.